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GRAY DRUG STORES, INC.

Annual report to shareholders
FOR THE YEAR ENDED JUNE 30, 1959

GRAY
DRUG STORES, INC.
AND SUBSIDIARIES

MAIN OFFICE and WAREHOUSE
2400 SUPERIOR AVENUE
CLEVELAND, OHIO

CITIES:	STORE UNITS: (June 30, 1959)
• Akron, O.	6
• Alliance, O.	1
• Ashtabula, O.	2
• Bradford, Pa.	1
• Canton, O.	4
• Chillicothe, O.	1
• Cincinnati, O.	9
• Cleveland, O.	21
• Columbus, O.	18
• Covington, Ky.	1
• Dayton, O.	5
• Fairborn, O.	1
• Fremont, O.	1
• Hamilton, O.	1
• Lorain, O.	1
• Mansfield, O.	4
• Massillon, O.	2
• Middletown, O.	1
• Newport, Ky.	1
• Painesville, O.	2
• Sandusky, O.	2
• Sheffield, O.	1
• Springfield, O.	1
• Stow, O.	1
• Steubenville, O.	2
• Warren, O.	4
• Willoughby, O.	1
• Wooster, O.	2
• Youngstown, O.	10

Gray Drug Stores, Inc. — the nation's eighth largest drug chain — operated 107 stores and employed approximately 2200 people as of June 30, 1959. Grays' stores — which dominate nearly every large city in Ohio, and border into Kentucky and Pennsylvania — serve a vast majority of the three millon homes in this trading area.

(* To open during current fiscal year)

BOARD OF DIRECTORS

CARLYLE W. EVANS	President, Gray Drug Stores, Inc.
HENRY H. GRAY	Vice-President, Gray Drug Stores, Inc.
CHARLES B. MERRILL	President, Merrill, Turben & Co.
GEORGE F. PRYOR	Vice-President, The Cleveland Trust Co.
JOHN W. REAVIS	Partner, Jones, Day, Cockley & Reavis
ADOLPH WEINBERGER	Chairman of the Board, Gray Drug Stores, Inc.
CARL WEINBERGER	Buyer, Gray Drug Stores, Inc.

OFFICERS

ADOLPH WEINBERGER	Chairman of the Board
CARLYLE W. EVANS	President
LLOYD C. DOUGLASS	Vice-President & Treasurer
HERBERT H. DURR	Vice-President
HENRY H. GRAY	Vice-President
MARVIN L. KAHN	Vice-President
MILTON M. NEUBAUER	Vice-President
JEROME WEINBERGER	Vice-President
LOUIS BERWITT	Secretary
ROBERT E. BREIG	Assistant Treasurer
JOSEPH VALINS	Assistant Secretary

TRANSFER AGENT AND REGISTRAR

THE CLEVELAND TRUST COMPANY ..... Cleveland, Ohio

AUDITORS

ERNST & ERNST ..... Cleveland, Ohio

COUNSEL

JONES, DAY, COCKLEY and REAVIS ..... Cleveland, Ohio

STOCK LISTED

MIDWEST STOCK EXCHANGE ..... Chicago, Illinois

REPORT TO STOCKHOLDERS

We present in this report the results of your Company's 31st year in operation.

Sales, income, and earnings per share were the highest in our history. Net sales of $35,991,357 represent an 11.6% increase over the previous year's sales of $32,249,706. Consolidated net income after taxes of $768,591 is equivalent to $4.75 per share on 161,925 shares outstanding June 30, 1959, as compared to $692,322, or $4.43 per share on 156,414 shares last year.

During the year, your Company opened eleven new stores and remodeled ten. Continuing the elimination of marginal profit units, one store was closed and five sold. There were 107 stores in operation June 30, 1959, including five in Ohio communities where we had not previously been represented.

Our photo-finishing operations at the Cleveland plant were enlarged by the installation of new modern equipment to handle developing and printing of color film. We are now enabled to supply all our stores with fast service on custom-quality color work. Inasmuch as color processing represents a large and rapidly growing portion of the photo-finishing field today, this move widens the scope of our plant for future business.

During April, 1959, an issue of 5% convertible debentures was sold in the amount of $2,313,500. The proceeds were used primarily to retire outstanding loans; the balance not so required provides additional working capital needed to operate our expanded chain.

With the growth of your company it has been necessary to adjust our operating organization to meet the needs of expansion. To this end, an exhaustive study was made, and all responsibility for company operations has been separated into four major divisions. These divisions are Operations Control, Merchandising, Financial and Administrative, and Future Planning — each directed by a vice-president who is responsible to the president.

The confidence of our customers and suppliers, the continued support of our stockholders, and the loyalty of our employees have all contributed to the successful year reported here. Our appreciation and best wishes are sincerely extended to them all.

Respectfully,

Adolph Weinberger CHAIRMAN OF THE BOARD

PRESIDENT

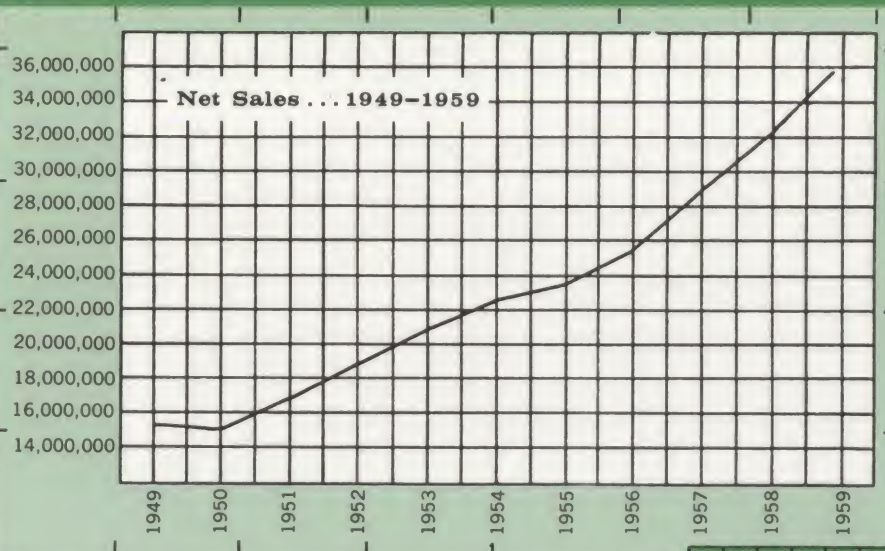
"REXALL" LINE NOW INTEGRATED IN 90 GRAY STORES

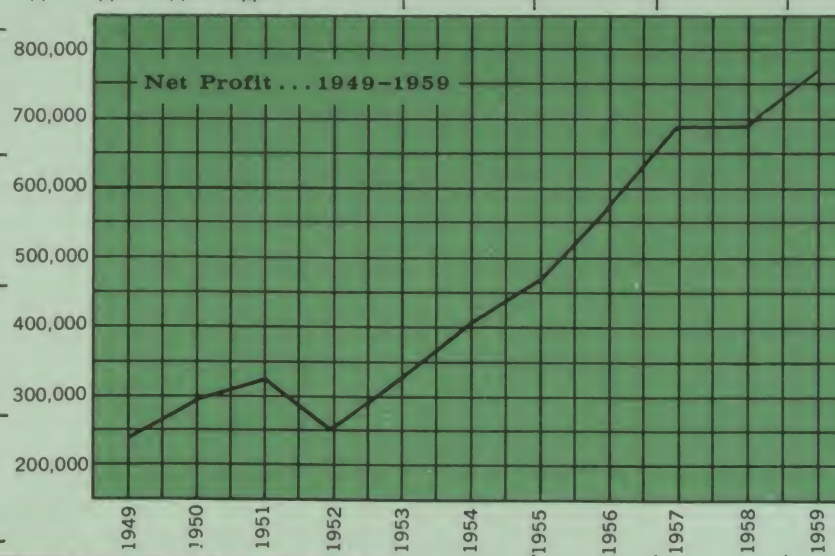
One year ago your Company reported completion of a franchise agreement with the Rexall Drug Company, for the sale and promotion of "Rexall" brand merchandise in our stores. Since that time we have made rapid progress in the integration of the Rexall line with Gray Drug merchandising. As of June 30, 1959, 90 Gray stores were "Rexallized".

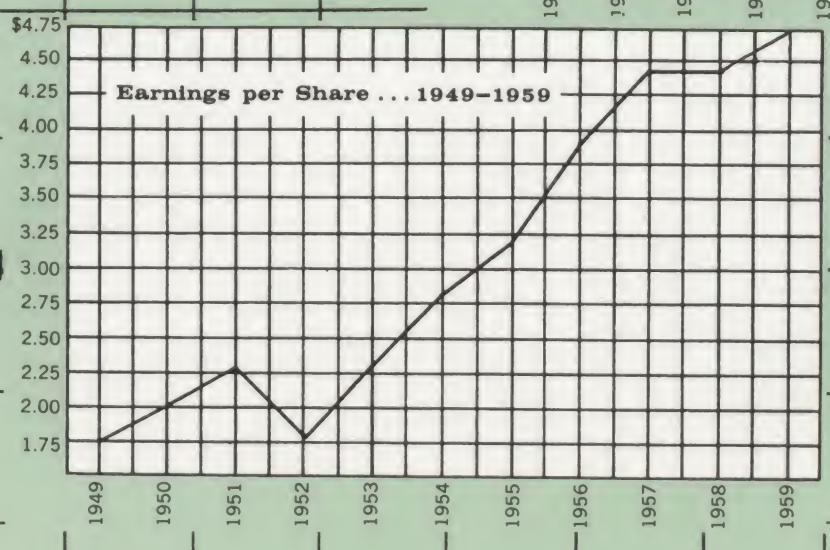
The introductory campaigns were carried out in geographical territories. As Rexall merchandise appeared on store shelves, our signs were changed to include the familiar orange-and-blue trademark; then a powerful barrage of introductory advertising was loosed — including newspapers, radio and television — in each city.

Customer acceptance of this move, thus far, has been gratifying. Your company expects the coupling of Rexall's powerful national advertising with Grays' local dominance to effect far-reaching long-range benefits.

COMPANY GROWTH







THIRTY-ONE YEAR RECORD OF PROGRESS

Fiscal	Stores End of Year	Net Sales	Net Income (3)	Earnings Per Common Share (4)	Dividends Paid Per Share
1929	17	$ 1,531,636	$120,107	$1.94	$ .81
1930	21	2,136,818	88,655	1.18	.97
1931	24	2,604,609	100,482	1.30	.98
1932	26	2,547,357	87,893	1.16	1.00
1933	26	2,498,932	80,382	1.06	1.00
1934	29	3,201,663	112,408	1.49	1.00
1935 (1)	29	1,790,809	57,587	.76	.50
1936	33	4,406,753	163,774	2.05	1.05
1937	37	5,384,723	243,088	3.04	1.90
1938	38	5,374,763	132,821	1.66	1.60
1939	38	5,154,803	113,863	1.42	.50
1940	40	5,509,435	139,430	1.74	.75
1941	39	6,925,221	172,476	1.92	1.00
1942	44	7,965,870	176,651	1.96	.75
1943	43	9,135,763	193,896	2.15	.50
1944	43	9,469,467	172,278	1.91	.75
1945	78	10,003,588	175,407	1.78	1.00
1946	91	14,700,500	366,910	2.47	1.22½
1947	91	17,496,500	388,284	2.80	1.30
1948	78	16,227,105 (2)	293,263	2.11	1.30
1949	79	15,643,806	241,014	1.74	1.05
1950	77	15,283,817	281,994	2.03	.80
1951	74	16,833,818	324,702	2.32	.80
1952	80	19,268,081	250,767	1.78	1.00
1953	78	21,075,426	327,898	2.32	1.00
1954	80	22,578,421	407,643	2.85	1.00
1955	78	23,390,391	470,560	3.20	1.00
1956	81	25,543,059	576,429	3.92	1.10
1957	86	29,333,474	690,880	4.42	1.40
1958	102	32,249,706	692,322	4.43	1.40
1959	107	35,991,357	768,591	4.75	1.60

(1) Six months ended June 30, 1935. Changed fiscal year from calendar year to one ending June 30.

(2) In addition to the drop in sales resulting from the sale of thirteen stores, at the beginning of this year state cigarette excise taxes are excluded from sales.

(3) Before reflecting reserves for contingencies which were restored to earnings retained in the business as of June 30, 1948.

(4) Based upon the number of shares outstanding at the end of each year, adjusted to reflect a stock split of 2 for 1 in February, 1930, and stock dividends of 3% in 1931 and 2% in 1932.

11 NEW STORES fashioned for

During the past year, your Company accelerated its planned expansion program — opening eleven new stores and remodeling ten. On these pages are views of two new units — one a typical large self-service store in a regional shopping center; the other, a custom-designed store in a 100% downtown location of a large city.

New GRAY-REXALL sign dominates store front in regional shopping center.

the future

Custom-designed front for downtown location.

Modern Open Front Prescription Department

Gray's Dutch Oven Fountain

Ultra-modern Cosmetic Department

Cigar Department occupies lobby island.

CONSOLIDATED

Gray Drug Stores Inc.

JUNE 30,

ASSETS

CURRENT ASSETS		
Cash		$ 2,177,134
Accounts receivable, less allowance of $10,000		245,596
State tax stamps		130,626
Inventories — priced generally on the basis of the lower of cost (latest) or replacement market:		
At stores	$4,984,928	
At warehouse	1,830,897	
	$6,815,825	
In transit	191,973	7,007,798
Prepaid expenses		150,168
TOTAL CURRENT ASSETS		$ 9,711,322
OTHER ASSETS		225,561
FIXED ASSETS — on the basis of cost		
Furniture, fixtures, and equipment	$3,533,866	
Leasehold improvements	2,226,255	
	$5,760,121	
Less allowances for depreciation and amortization	2,434,925	3,325,196
		$13,262,079

BALANCE SHEET

and Subsidiaries

1959

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES		
Accounts payable and accrued expenses:		
Trade accounts	$1,988,484	
Salaries, wages, and commissions	422,923	
Accrued expenses	461,269	
Rent and interest	192,250	
Payroll taxes and amounts withheld from employees	132,285	
Taxes, other than federal taxes on income	208,636	$ 3,405,847
Federal taxes on income — estimated		674,772
TOTAL CURRENT LIABILITIES		$ 4,080,619
5% CONVERTIBLE DEBENTURES DUE 1974 — Note A		2,313,500
SHAREHOLDERS' EQUITY		
Common Stock, par value $1.00 a share— Notes A and B:		
Authorized — 500,000 shares		
Outstanding — 161,925 shares	$ 161,925	
Capital in excess of par value — Note C	2,152,792	
	$2,314,717	
Earnings retained for use in the business — Note A	4,553,243	6,867,960
		$13,262,079

See notes to financial statements.

STATEMENT OF

CONSOLIDATED EARNINGS

RETAINED FOR USE IN THE BUSINESS

GRAY DRUG STORES, INC. AND SUBSIDIARIES

Year ended June 30, 1959

Balance at July 1, 1958		$ 4,041,372
Net income for the year		768,591
		$ 4,809,963
Cash dividends declared:		
$.40 a share paid October 1, 1958	$ 63,590	
$.40 a share paid January 1, 1959	63,590	
$.40 a share paid April 1, 1959	64,770	
$.40 a share paid July 1, 1959 — Note D	64,770	256,720
BALANCE AT JUNE 30, 1959		$ 4,553,243

See notes to financial statements.

STATEMENT OF

CONSOLIDATED INCOME

GRAY DRUG STORES, INC. AND SUBSIDIARIES

Year ended June 30, 1959

Net sales	$35,991,537
Cost of goods sold	22,508,484
	$13,483,053
Other operating income	107,834
	$13,590,887
Selling, general, and administrative expenses	11,967,995
	$ 1,622,892
Other income	69,239
	$ 1,692,131
Interest expense	84,540
INCOME BEFORE FEDERAL TAXES ON INCOME	$ 1,607,591
Federal taxes on income — estimated	839,000
NET INCOME	$ 768,591

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

GRAY DRUG STORES, INC. and SUBSIDIARIES
Year ended June 30, 1959

Note A — 5% Convertible Debentures Due 1974:

The indenture under which the debentures were issued provides for annual sinking fund payments on February 15 of each year beginning in 1964. The amounts of such payments will be $115,675 from 1964 through 1968 and $161,945 from 1969 through 1973.

The debentures are convertible into shares of Common Stock of the Company at the option of the holder at any time on or before April 1, 1974, at a conversion price (subject to adjustment in certain events) of $47.50 per share until April 1, 1964, $52.00 per share thereafter until April 1, 1969, and $56.00 per share thereafter until maturity. 48,706 shares of authorized but unissued Common Stock are reserved for conversion of the debentures.

Under the terms of the indenture, earnings retained for use in the business in the amount of $1,108,765 are available for distribution to shareholders at June 30, 1959.

Note B — Stock options:

On May 24, 1955, options were granted to certain officers and key employees (three of whom are directors) to purchase 15,000 shares of the Common Stock of the Company. The option price was $16.37½ per share, which represents the quoted market value at the date of grant, except that the option price to two employees (related to principal shareholder) was $18.70 per share to permit qualification as a restricted stock option. The aggregate option price of all shares was $253,995.

All of the options became exercisable on May 24, 1957. During the year ended June 30, 1959, options were exercised for 5,511 shares, which represented all of the remaining shares subject to option.

Note C — Capital in excess of par value:

The increase of $91,383 in capital in excess of par value during the year ended June 30, 1959, represents the excess of proceeds from sales of Common Stock under the Company's stock option plan over the aggregate par value of such shares.

Note D — Dividends:

The Company deposited funds with the dividend disbursing agent on June 30, 1959, for payment of the dividend payable July 1, 1959.

Note E — Long-term leases:

The companies were lessees at June 30, 1959, under a number of leases extending from one to eighteen years. The aggregate annual minimum rental payable under such leases (many of which provide for additional rental if amounts based on specific percentages of sales exceed the minimum) amounted to approximately $1,512,000.

Note F — Depreciation and amortization:

Allowances for depreciation and amoritization of fixed assets amounted to $575,139 for the year.

Note G — Pension plan:

Total contributions under the pension plan for employees of the companies amounted to approximately $148,000 for the year ended June 30, 1959, including amortization of the cost of past service benefits to retirement age of participants. At June 30, 1959, the unfunded cost of past service benefits was approximately $23,000.

ACCOUNTANT'S REPORT

Board of Directors,
Gray Drug Stores, Inc.
Cleveland, Ohio.

We have examined the consolidated financial statements of Gray Drug Stores, Inc. and subsidiaries for the year ended June 30, 1959. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying balance sheet and statements of income and earnings retained for use in the business present fairly the consolidated financial position of Gray Drug Stores, Inc. and subsidiaries at June 30, 1959, and the consolidated results of their operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

ERNST & ERNST
Certified Public Accountants

Cleveland, Ohio
August 26, 1959

GRAY
DRUG STORES